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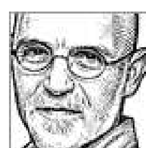
Haunted by the Bull That Got Away

ByJason Zw eig

Matt Collins

It might have been.

Those aren't only the saddest words for lovers, as **the poet John Greenleaf Whittier wrote**, but also for investors.



The Intelligent Investor
By Jason Zweig
COMMENTARY

The pain of missing out on the tripling of the U.S. stock market since March 2009 has become almost unbearable for many investors who have been watching from the sidelines, financial advisers say.

Some who got out of stocks five years ago are fixating on how much richer they would have been if they had stayed put. Others are suffering the social distress of listening to friends bragging about their bigger returns.

Psychologist Daniel Kahneman, who won the Nobel Prize in economics in 2002, likes to say that one of the keys to investing successfully is properly anticipating your regret.

Learning from other people's remorse now may help you minimize your own later—by learning how to reframe your regrets and by making gradual changes to your investing plan that are likely to keep you from doing anything rash.

Jim MacKay, of MacKay Financial Planning in Springfield, Mo., says two couples who are new clients of his firm both took nearly all their money out of U.S. stocks in late 2008 and early 2009 and have kept it in cash ever since.

After U.S. stocks returned 32% last year, Mr. MacKay says, these couples are asking themselves, "Uh-oh, what have we done?" They asked to put at least half their money back into stocks—all at once.

Several other financial advisers told me this past week about clients who are chafing to move most or all of their money into stocks. Often, those who lost the most in 2008 and 2009—and begged to be taken out of stocks entirely—are the most eager to pile back in now.

"Some investors have an overwhelming, self-defeating desire to adjust their asset allocation based on recent past results," says Frank Armstrong, president of Investor Solutions, a financial-advisory firm in Miami. "While markets are reasonably efficient, many investors are hopelessly inefficient."

Recent returns can distort your behavior for different reasons. If you have been riding the market's upsurge, you may feel as if you can afford to take extra risks with "**house money," or profits in excess of your own capital**—much the way casino gamblers tend to bet more aggressively after a big score.

Conversely, if you have missed out, you may chase the rising market in a desperate attempt to get back to "break-even," or the level of wealth you would have had if you had stayed in all along.

Recent gains or losses change how the human brain assesses risk, according to **a study that will appear later this year** in a well-regarded psychology publication, the Journal of Economic Behavior & Organization.

People were roughly 20% more likely to take a gamble after either a gain or loss than after a neutral outcome, the study shows. During the experience of profits and losses alike, several regions of the brain involved in emotion became more active, while activity dwindled in areas devoted to executive decision-making.

"The experience of gain or loss appears to reduce your deliberation, how much you think about and pay attention to your decisions," says neuroeconomist Kaisa Hytönen of the Aalto University School of Science in Espoo, Finland, the lead author of the study. "That relative lack of deliberation may be driving you to take more risk in your future choices."

In this experiment, a loss didn't mean going into the red—just missing out on a bigger gain. **Earlier research has demonstrated** that a near miss can prod you into taking much bigger risks than you might otherwise have been willing to run.

How can you take some control over your investing regrets?

First, engage in what Eric Johnson, a psychologist and director of the Center for Decision Sciences at Columbia Business School, calls "therapeutic reframing," or looking at the same evidence from a different angle.

If you are kicking yourself for having gotten partly out of stocks, focus on the fact that you didn't get out entirely. Instead of lamenting how much higher your returns would have been over the past five years if you hadn't reduced your stock exposure in 2008 or 2009, take a moment to calculate how much lower your performance would have been had you sold out completely.

And if you feel you absolutely must buy more stocks to catch up, do so gradually by tiptoeing in over the next year or two in equal monthly installments—as Mr. MacKay, the financial planner, is doing for his clients.

That is especially important when you bear in mind that U.S. stocks fell 57% between 2007 and 2009; if you couldn't stand that pain then, you have no business clamoring to buy stocks now.

Tiptoeing your way back in, rather than plunging in with both feet, will leave you with a lot less regret if the market goes off a cliff like that again.

— Write to Jason Zweig at intelligentinvestor@wsj.com, and follow him on Twitter:@jasonzweigwsj

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